United States Court of Appeals

for the Second Circuit

APPELLANT'S BRIEF

ORIGINAL

75-7284

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United States Court of Appeals
FOR THE SECOND CIRCUIT

P/S

LAWRENCE R. BARNETT, C. LEONARD GORDON and ALFRED L. HOLLENDER,

Plaintiffs-Appellants,

against

DON KIRSHNER, IRVING COHEN, HERBERT T. MOELIS and KIRSHNER ENTERTAINMENT CORPORATION,

Defendants-Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT SOUTHERN DISTRICT OF NEW YORK

BRIEF OF THE PLAINTIFFS-APPELLANTS

BERGREEN & BERGREEN
Attorneys for Plaintiffs-Appellants
660 Madison Avenue
New York, New York 10021

GORDON, HURWITZ, BUTOWSKY & BAKER
Attorneys for Plaintiffs-Appellants
330 Madison Avenue
New York, New York 10017

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Plaintiffs-Appellants,

-against-

DON KIRSHNER, IRVING COHEN, HERBERT T. MOELIS and KIRSHNER ENTERTAINMENT CORPORATION,

Defendants-Appellees.

---x

Docket No. 75-7284

BRIEF OF THE PLAINTIFF-APPELLANTS

PRELIMINARY STATEMENT

This is an appeal by plaintiffs, Lawrence R. Barnett ("Barnett"), C. Leonard Gordon ("Gordon") and Alfred L. Hollender ("Hollender") from a judgment entered April 15, 1975 in the United States District Court for the Southern District of New York, after a bench trial before the Hon. Whitman Knapp, United States District Judge. The opinion and order of the Court, signed April 1, 1975 are reproduced at p. 19a.*

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* Citations to the joint appendix are designated by page numbers ending in "a"; citations to the trial transcript as "tr. p. ___." and to exhibits as "exh.____."

INTRODUCTION AND SUMMARY OF ARGUMENT

In this brief, we show that defendants' conduct in buying out the plaintiffs, their co-venturers in a close corporation, while simultaneously and secretly obtaining valuable properties for the company, was a violation of the securities laws. Judge Knapp's findings and opinion acknowledged:

> "If the sales of plaintiffs' stock were consummated after mid-February, as plaintiffs contend, it is clear that the defendants' admitted failure to disclose the potential transaction would constitute a violation of the federal securities laws. There can be little doubt that this information would be considered highly relevant to a reasonable investor deciding whether or not to sell his shares in a corporation." (19a-20a)

But Judge Knapp found (we contend, erroneously) that the sales were all completed days before negotiations began for acquisition of the properties by the company. And thus, according to the Court, no disclosure was required. This holding depends upon Judge Knapp's ruling that certain "consents" were no part of the sales transactions. For if they were, the transactions were not complete until months after the properties were acquired. Since the facts are available to this Court and based on written agreements, the District Court's finding is freely reviewable on appeal. In Point I below, we show that the consents were an integral part of the bargain, designed to pass good title to defendants while

satisfying plaintiffs' obligations under the shareholders' agreement which governed the joint venture.

As shown in Point II(A) below, as a matter of contract law, the consents constituted a condition precedent. Until the condition was satisfied, plaintiffs' sales were not complete, and the plaintiffs remained shareholders, entitled to full disclosure, and to exercise informed consents to the transactions. Indeed, the condition was not timely met, and the consents were null and void after March 1, 1969. Plaintiffs at that time were entitled to call the deal off. Defendants' failure to disclose material inside information cheated the plaintiffs of the opportunity to deal with the defendants on an equal footing.

In Point II(B) below, we show that as a matter of securities law, the fixing of the time of a sale should be set to effectuate the purposes of the Securities Exchange Act, and thus to promote full disclosure of material information in connection with the purchase and sale of stock.

In Point III below, we show that defendants' concealment of the true identity of the purchaser of plaintiff Hollender's shares constituted a material omission which defendants admitted was done because they thought Hollender would not sell if they told him the truth.

For all of these reasons, plaintiffs are entitled to have the judgment of the District Court reversed, and a judgment entered in their favor.

ISSUES PRESENTED

1. Whether, where transactions are evidenced by documents, the reviewing appellate court may reverse upon a finding of error.

2. Whether, where a condition precedent to a sale is not satisfied, the sale is complete.

3. Whether, in a sale of stock requiring consent of all shareholders of a close corporation, the obtaining of the consents is "in connection with" the purchase and sale of the securities, so that full disclosure of material information is required pending the obtaining of the consents.

4. Whether defendants' acts in hiding from plaintiff Hollender the true identity of the purchaser of his shares, conceded by the purchasing defendant to have been arranged in that fashion as otherwise Hollender would not have sold, is a material non-disclosure.

FACTS

In 1967, defendant Don Kirshner ("Kirshner") formed a venture to develop musical properties.* (Exh. 2) Kirshner became President, and Moelis, Vice-President. Plaintiffs Gordon, Barnett and Hollender purchased stock

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* This corporation, its various subsidiaries, and related companies, will be referred to as "KEC" throughout this brief for simplicity.

(32a). KEC was set up as a "close corporation" to protect the interests of defendant Kirshner's backers. Thus, by the initial shareholders' agreement, control was to be lodged primarily in the Kirshner group, who held four of the seven seats on the Board of Directors. However, on matters of importance, concurrence of five of the seven Board members was required, giving the outside group (which included the plaintiffs) a say in these matters through the power to withhold the consent of their three board members. In addition, all of the shareholders were assured that no others would be brought into their venture without their approval. This was accomplished by means of a right of first refusal in each of the shareholders, and the corporation, before any shareholder could sell his shares. (Exh. 2, page 1 and para. 2, 7, 9)

In early 1968, the defendant Cohen became a shareholder, and also counsel to the corporation. Cohen had for many years represented Alan J. Lerner, a well-known lyricist. (Tr. 256, 257)

In 1968, plaintiffs Barnett, Gordon and Hollender owned an aggregate of 22,000 shares of stock of KEC and notes of KEC totalling $86,000 and they were obligated to advance additional loans to the corporation upon demand by KEC (32a).

In about November or December 1968, plaintiff Hollender, at the invitation of defendant Kirshner, met with Kirshner and defendant Moelis, at the office of KEC. At that time Kirshner and Moelis told Hollender that the plaintiff Barnett had been complaining about the way they were spending money. Kirshner and Moelis requested that Hollender tell Barnett that "if he wants to get out, we will take him out." Kirshner and Moelis also asked Hollender "to talk to" his fellow shareholders, plaintiff Gordon and James Rochlis, "and tell them the same thing" and to tell his three associates that "there is going to be a call for more money and if they don't like the idea we will take them out" (Tr. 66-72; 106; 212-213, 239).

Mr. Hollender then related the message from Kirshner and Moelis to Gordon, Barnett and Rochlis. He told Mr. Barnett "More money might be needed" that "they [Kirshner and Moelis] knew he was unhappy and that Kirshner

would buy [Barnett] out'.

Hollender told Mr. Gordon "there was a good chance that Kirshner Entertainment was going to call for more money" and that "they [Kirshner and Moelis] were prepared to buy out anybody who was dissatisfied." (Tr. 67-68; 72-3; 138; 140)

Barnett and Gordon were non-committal; they told Hollender they "wanted to think about it." Hollender called Kirshner and reported their response. (Tr. 70).

The defendant Moelis acknowledged that he knew that all of the stockholders had to consent before any stock from any stockholder could be purchased (Tr. 220). On December 9, 1968, Moelis wrote a letter to the defendant Cohen captioned "re: Barnett-Cohen, Rochlis-Kirshner, Gordon-Moelis," in which he outlined how "the transaction should operate," enclosed the "stockholders agreement" and stated that "he was presented with two problems," one of which was

> "A. Len Gordon is leaving for Japan this Wednesday, December 11. Therefore, I think it is adviseable (sic) that we close this deal at once." (115a-116a)

Cohen's law partner, David Grossberg, replied

by memorandum dated December 12, 1969, which stated:

> "Please find enclosed a receipt, letter dated December 10, 1968*, undated letter and stock powers. These should be signed by C. Leonard Gordon, except that the letter of December 10th has to be signed not only by Gordon, but by all of the other stockholders listed in paragraph '1' and yourself.
>
> I believe you will find these in order, since they follow closely the papers used in the prior transfer...
>
> The letter of December 10th will have to be duplicated so that all of the other parties can sign." (117a)

After his conversation with Hollender, Barnett called the defendant Moelis who confirmed that the defendant Kirshner would buy Barnett's stock. Barnett replied "Well, draw up the papers and I will deliver you the stock and the notes." Later in December, Moelis told Barnett that the defendant Irving Cohen was going to be the purchaser and that Barnett should contact Cohen's partner who was preparing the papers (79a-80a).

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* This was an earlier draft of the consent letters which appear at 122a-123a; 126a-127a; and 134a-135a.

Gordon also told Moelis he was willing to sell after he spoke to Hollender and confirmed it to Cohen on or about December 27, 1968. (Tr. 162, 163).

The defendant Cohen and his law firm were the attorneys for KEC and each of the purchasers and prepared all of the papers involved in defendants' proposed purchase of plaintiffs' stock. (Tr. 297-298). Gordon is an attorney; Barnett and Hollender are not and were not represented by independent counsel in the transactions. (Tr. 152, 80-1, 140-1)

Grossberg, Cohen's partner, prepared a form letter which he mailed to each of the stockholders of KEC on December 23, 1968. The letter stated:

> "C. Leonard Gordon and Lawrence R. Barnett are selling out their interests in Kirshner Entertainment Corporation, Don Kirshner Music, Inc. and KEC Music, Inc.* Mr. Gordon's interest is being sold to Herb Moelis and Mr. Barnett's interest is being sold to Don Kirshner and Irving Cohen.
>
> In order to effectuate this transfer, consent of the other stockholders is required, and we are therefore enclosing copies of letters of consent.
>
> We would appreciate your signing in the space indicated by your pencilled initials, and returning these to us in the self-addressed envelope enclosed for your convenience." (118a)

---

* These corporations are referred to in this brief, collectively, as "KEC."

PLAINTIFF BARNETT'S SALE OF STOCK TO DEFENDANTS COHEN AND KIRSHNER

Late in the afternoon of December 30, 1968, Grossberg called on Barnett and presented him with the closing papers. They included two of the three letters, copies of which Grossberg had previously mailed to the other stockholders of KEC for execution and return, designated "letters of consent." (Tr. 142-3)

Both letters were addressed to KEC, Don Kirshner Music, Inc., KEC Music, Inc., "and each individual who is a party to any of the Agreements (the 'Agreements') identified in Paragraph '1' below." These included the selling plaintiffs Gordon and Barnett. These consent letters were dated December , 1968 (sic.) (126a).

The first letter was from Cohen, who acknowledged in the first paragraph that he had been provided with and had read the agreements among the parties including the Stockholders' Agreement dated June 26, 1967.

Cohen's letter then stated:

> "2. To induce you to permit me to purchase one-half of all of the common stock of Entertainment, DKMI and of KEC owned by Lawrence R. Barnett and to arrange to lend to Entertainment together with the purchaser of the other one-half (1/2) of said common stock, the sum of $32,000, on the same terms and conditions as the said loan by Barnett, I hereby agree, effective from the date on which such purchase shall be completed, to become and be bound by each of the Agreements as if I had been named a party thereto in

place of Lawrence R. Barnett with respect to stock being purchased by me, and had been so named therein at the time of their original execution. Effective from such date, each of you releases Lawrence R. Barnett from any and all liability under the Agreements.

* * *

4. Your consent to the transactions contemplated by this Agreement dated December 1968, (the 'December 1968 Agreement') shall, in relation to such transactions, constitute a waiver of the rights granted to you pursuant to Paragraph '2' of the Stockholders' Agreement identified in Paragraph '1(b)' of this December 1968 Agreement.

5. If the transactions contemplated by this December 1968 Agreement are not consummated on or prior to March 1, 1969, this December 1968 Agreement shall be null and void.

If you are in agreement with the foregoing, please execute three counterparts of this December 1968 Agreement and return them to Cohen & Grossberg, 505 Park Avenue, New York New York 10022. This December 1968 Agreement shall become effective upon the receipt by Cohen & Grossberg of counterparts of this Agreement duly executed by Entertainment, KEC, DKMI and each of the individuals named in Paragraph '1' hereof." (126a-127a)

The second letter was from Don Kirshner; it was identical in substance with the Cohen letter, except that it sought permission for Kirshner to purchase the other one-half (1/2) of Barnett's stock. (128a-129a)

Barnett signed the letters from Cohen and Kirshner and also executed a receipt dated December 30, 1968 and a

letter dated December 30, 1968 from Barnett to Cohen and Kirshner, which acknowledged the sale of Barnett's stock and satisfaction of his note. (Tr. 143; 124a, 125a)

PLAINTIFF GORDON'S SALE OF STOCK TO DEFENDANT MOELIS

After his meeting with Barnett, Grossberg met with the plaintiff Gordon at about 6 P.M. on December 30, 1968. (Tr. 166-7) The papers which Grossberg submitted to Gordon at that time included the third letter of consent which Grossberg had forwarded to the other stockholders in his letter of December 23, 1968. This letter was from the defendant Moelis; it was dated "December , 1968"; and it was addressed to the same parties and was the same in substance as the two letters in the Barnett transaction except it sought permission for Moelis' purchase of Gordon's stock. (122a-123a)

Gordon signed the consent letter from Moelis. He also signed a letter to KEC dated December 30, 1968; an undated letter to Moelis which acknowledged that Gordon had sold his stock and that his notes had been satisfied; and a receipt dated December 30, 1968 (122a-123a; 120a-121a).

PLAINTIFF HOLLENDER'S SALE OF STOCK TO DEFENDANT COHEN

Although he had been told that there was "going to be a call for more money" and that Kirshner and Moelis "would be glad to take out [anybody] who is unhappy," Hollender in-

tended to retain his stock in KEC (Tr. 67, 69-70). However, on Sunday, January 6, 1969, Hollender was told that Kirshner had prevailed upon his associate Harry Saltzman to fire Hollender's friend David Haft from a motion picture they were jointly producing (Tr. 73, 75).

The following morning, January 7, 1969, Hollender attempted several times to reach Kirshner by phone but was told Kirshner was unavailable (Tr. 76-77, 80). Finally, Moelis got on the phone and, in response to Hollender's inquiry about the firing of Haft, said "It is none of your business." Hollender replied, "Gee, in view of our relationship, that is a rather surprising answer." Moelis then said:

> "If you don't like the way we are running the company, why don't you get out and we will give you your money back." (Tr. 77)

Hollender then called Cohen, counsel to KEC, and asked for an explanation. Cohen was "noncommital" and replied:

> "Well, if you want to sell your stock and they told you they would take you out, I will work it out and maybe that's the best thing to do." (Tr. 79)

On January 10, 1969, Hollender wrote the following letter to "Kirshner Entertainment":

> "Gentlemen:
>
> In accordance with your recent offer to repurchase my stock interest in Kirshner

Entertainment, this is to advise you that I have elected to accept.

Will you please make arrangements for my withdrawal as a stockholder as soon as it is expedient." (130a)

On January 27, 1969 Cohen replied:

"Dear Al:

My partner and I have tried to reach you by phone several times today in order to complete the transaction of the repurchase of your stock in Kirshner Entertainment Corporation, KEC Music, Inc. and Don Kirshner Music, Inc.

I have the check ready for you, together with the papers ready for your signature, and would appreciate receiving your stock certificates, endorsed in blank by you.

I am leaving for the Coast at the end of the day tomorrow, and I am anxious to close either at the end of the day today, or tomorrow morning." (131a)

On the afternoon of January 29, 1969 Benjamin Zinkin, a lawyer associated with Cohen, called on Hollender with the closing document for that transaction. Hollender said: "Gee, you know we have a good lawyer downstairs, meaning Gordon . . . I really ought to take these papers down and show them to him." Mr. Zinkin replied: "There really is no need for that. They are all matters of form. Why don't you sign them?" (Tr. 81-82; 294).

Hollender protested "it was late in the day, and I wanted to go home; there was a heavy snowstorm." Hollender

repeated that he "wanted to go down to Mr. Gordon and show him all these documents before I signed them." Zinkin replied: "It is not necessary. You can trust us." (Tr. 122-123).

Among the documents which Hollender signed was a consent letter from Cohen dated January 29, 1969 (134a-135a). It named the same addressees and was in all respects identical to the "letters of consent" in the Barnett and Gordon transactions except that the first paragraph identified the "successor" parties to the agreements listed in it and the second paragraph was changed and stated:

> "2. To induce you to permit me to purchase all of the common stock of Entertainment, DKMI and of KEC owned by Alfred L. Hollender, and to arrange to lend to Entertainment the sum of $32,000.00 on the same terms and conditions as the said loan by Hollender, I hereby agree, effective from the date on which such purchase shall be completed, to become and be bound by each of the Agreements as if I had been named a party thereto in place of Alfred L. Hollender with respect to stock being purchased by me, and had been so named therein at the time of their execution. Effective from such date, each of you releases Alfred L. Hollender from any and all liability under the Agreements. <u>It is understood that I am purchasing these shares and lending this money in my own name, but that I may assign this interest to others</u>, and in such event the approval herewith given with respect to my purchase and loan shall apply to my assignees upon their acceptance of this document and the provisions hereof." (Emphasis added.)

Cohen was not the purchaser. He was acting as a

nominee for Irving Moskovitz, who was in turn a nominee for Saltzman. This was not disclosed to Hollender. (111a)

The reason for the double nominee arrangement was that Cohen knew that if Hollender became aware of the identity of the purchaser, he would not have sold. Cohen prepared a mememorandum dated May 20, 1970, in which he wrote:

> "January 29, Wednesday, Hollender Transaction.
>
> On January 27, 1969, Saltzman met with Moskovitz, Kirshner, Moelis and Cohen in Kirshner's office. Saltzman was to discuss many aspects of the company. Saltzman told that Hollender was selling his stock. 'Was he willing to buy it?' Saltzman said, 'Yes'
>
> Saltzman wanted Moskovitz to hold the stock as a nominee and Hollender was moving and wanted the company's transaction as quickly as possible for he had very little time.
>
> Saltzman didn't want Hollender to know that he was buying any shares because he fired Haft and because of this fight he therefore wanted Moskovitz to buy stock in his name and to use Cohen as a nominee vis-a-vis Hollender." (49a-50a; Tr. 353-354)

In his opening, defendants' counsel stated (40a-41a; Tr. 21-22):

> ". . . everybody believed that if Hollender knew that his shares were going to Saltzman . . . there was no way he was going to sell those shares . . . . Their feeling was if Hollender knew it was Saltzman who was buying him out, he never would have sold . . . ."

Hollender testified that he would not have agreed

to sell his stock if he knew that Saltzman was the real purchaser. He said he would have "smelled a rat" because Saltzman had previously refused to invest in KEC (Tr. 99, 117-121).

DEFENDANTS OBTAIN VALUABLE MUSICAL PROPERTIES

On February 2, 1969, the next business day following the execution by Hollender of the papers for the sale of his stock, Moelis and Cohen had a telephone conversation concerning obtaining the rights to Cohen's client Lerner's musical properties for Cohen's other client, KEC (Tr. 259; 36a).

It was stipulated and the District Court found:

> ". . . it is undisputed that as of February 11, 1969 defendants Kirshner and Moelis had met with Alan Jay Lerner and defendant Cohen to discuss the possibility of KEC acquiring the Lerner properties. If the sales of plaintiffs' stock were consummated after mid-February, as plaintiffs contend, it is clear that the defendants' admitted failure to disclose the potential transaction would constitute a violation of the securitites laws." (19a-20a)

It was also stipulated that by February 17, 1969, Moelis and Alan Jay Lerner's representative had met and "they proceeded with the negotiations for acquisition of the Lerner properties by KEC." (37a)

However, during this period, the consents had not been obtained for the purchases of plaintiffs' shares. On February 19, 1969 Cohen's partner David Grossberg mailed the following letter to the other stockholders of KEC:

> "Dear Sir:
>
> Alfred L. Hollender is selling out his interest in Kirshner Entertainment Corporation, Don Kirshner Music, Inc. and KEC Music, Inc. His interest is being purchased in the name of Irving Cohen for further assignment by Mr. Cohen.
>
> We enclose a copy of a letter of consent to this transfer, which we would appreciate your signing in the space indicated by your pencilled initials, and returning the same to us in the self-addressed envelope enclosed for your convenience." (136a)

The minutes of the KEC directors' meeting of April 4, 1969, signed by Cohen as secretary show that the transactions contemplated by the letters which each of the plaintiffs signed, and which Grossberg enclosed in his transmittal letters of December 23, 1968 and February 19, 1969, were not presented to KEC's Board for consideration until April 4, 1969 -- more than a month after the March 1, 1969 deadline specified in the consent letters. Even then, only four instead of the five directors required by the Stockholders' Agreement purportedly ratified, confirmed and approved the transactions. (139a-140a)

The District Court found:

"The documents upon which plaintiffs rely were certain waiver forms sent by the defendant-purchasers to the non-selling shareholders in which the latter were asked to waive their option rights under the stockholders' agreement. It is clear from the evidence that such waivers were not fully completed until sometime after the KEC-Lerner negotiations began." (22a-23a)

ARGUMENT

POINT 1

JUDGE KNAPP ERRED IN HOLDING THAT THE CONSENTS WERE NOT A PART OF THE TRANSACTIONS BETWEEN PLAINTIFFS AND DEFENDANTS

A. The Relevant Standard

The central issue in this case, viz whether the consents were part of the sales transaction, was determined solely upon documentary evidence. Accordingly, it is freely reviewable on appeal. Shiya v. The National Committee of Gibran, 381 F.2d 602, 606 (2d Cir. 1967).

B. The Consents Were An Integral Part Of The Sale Transactions.

Here, a reading of the relevant documents shows conclusively that the consents were an integral part of the transactions.

The shareholders' agreement of June 26, 1967 provided for rights of first refusal in the corporation, and in the shareholders, prior to a sale of stock by any of the shareholders (Exh. 2, para. 2). To satisfy these requirements, a consent form was included in the sales transactions. This protected the buying defendants against claims by other shareholders that the sales were ineffective and the selling

plaintiffs against claims of breach of the shareholders' agreement. The consent forms were drafted by the defendant Cohen's law firm. (Tr. 297-8)

For each of the three transactions, the buying defendant delivered the consent form to the selling plaintiff, along with the other documents of sale. These consents, in all three transactions, were executed by the selling plaintiffs simultaneously with the other documents of sale. (Tr. 142-3; 166-7; 81-82; 122-3).

The preparation and delivery of these consents by defendants, and the execution of them by plaintiffs, were not merely ceremonial acts. They were plainly intended to have some legal effect. The parties clearly understood these consents to be a necessary part of the transaction. Each consent agreement addressed to the selling plaintiffs (as well as to non-selling shareholders) by the buying defendants, recited that it was entered into "to induce you to permit me to purchase all of the common stock of [KEC and related companies] owned by [plaintiff]. . ." The consent form further provided that the transactions would be complete, and the buying defendants would become bound when all consents were obtained, and set a time limit (to March 1, 1969) in which to obtain these consents.

The District Court's error is evidenced by the ironic result the Court reached. According to the Court,

plaintiffs breached the shareholders' agreement by executing the sale documents prepared for them by the controlling shareholders, and the corporation's lawyer. (23a*) This is an absurdity not intended by any of the parties who were plainly trying to comply with the shareholders' agreement, not to breach it. It is a commonplace that an interpretation is preferred which will make the agreement lawful and valid. Corbin on Contracts, §§545 et. seq. This court should read the consent form as a part of the sales transaction.

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* The Court's ruling that plaintiffs failed to offer their shares first to the corporation (23a) simply overlooks the fact that Hollender addressed his acceptance to the offer to buy back his shares to the corporation (130a); and that Barnett and Gordon were selling their shares to the corporation's officers, counsel and control group.

POINT II

DEFENDANTS' OMISSIONS TO DISCLOSE MATERIAL FACTS WERE IN CONNECTION WITH THEIR PURCHASES OF PLAINTIFFS' STOCK

Both as a matter of traditional contract law, and of Federal securities law, the sales were not complete until all of the consents were obtained, as required. Thus defendants' omissions to disclose the purchase of valuable properties by the company before the consents became effective were omissions "in connection with" defendants' purchase of plaintiffs' stock; and thus actionable under Sec. 10(b) of the Securities Exchange Act, and Rule 10b-5 promulgated thereunder.*

A) The Consents were Conditions Precedent to the Sales

As shown above, the sale transactions were subject to the shareholders' agreement of June 26, 1967 (Exh. 2). To comply with its terms, defendants caused consent forms to be prepared for execution by the selling plaintiffs,

* The defendants conceded, (Tr. 299,) and the trial court correctly found the non-disclosures to be material and a violation of the Securities law if in connection with the sale (20a). Accordingly, those points are not addressed here.

and all other shareholders. These consents were to become effective, and the sales with them, as soon as all of the consents were received. (Exh. 17; 45; 67, Para. 5). The consents were to become null and void, and the sales with them, if the transactions had not become effective by March 1, 1969. (Id.) In fact, the consents of KEC to each of these transactions were not given until April 4, 1969 (139a-40a)

Agreements of this kind, even when embodied in separate instruments, or parol agreements apart from the contract between the parties, are treated as conditions precedent. Until these conditions are satisfied, the transactions are not complete and the parties are not bound. Detroit Football Company v. Robinson 186 F. Supp. 933 (E.D. La. 1960), aff'd, 283 F.2d 657 (5th Cir. 1960); Pugh v. Fairmont Gold and Silver Mining Co., 112 U.S. 238 (1884); Smith v. Dotterweich, 200 N.Y. 299 (N.Y. 1911); Hicks v. Bush, 10 N.Y. 2d 488, 255 N.Y. Supp. 2d 34 (1962).

The uncontested proof showed that the conditions precedent to each of the plaintiffs' sales (the receipt of the consents of all of the shareholders and of the

corporation) were not satisfied until April 1969, if at all. Since these were not obtained before March 1, 1969, the transactions were null and void, and plaintiffs were entitled to withdraw their consents, and to be discharged from their obligations. (See, e.g., Exhs. 17, 45, 67 at para. 5). The failure of defendants to inform plaintiffs of the newly enhanced value of their shares throughout this entire period deprived plaintiffs of the opportunity to exercise their rights. The final transfer of rights was accomplished while defendants had an unfair advantage by reason of their inside information. Under these circumstances, the material ommissions were "in connection with" the purchase by defendants of plaintiffs' stock.

B) As a Matter of Securities Law, Defendants' Material Omissions Were "In Connection With" Their Purchase Of Plaintiffs' Securities

Where alternate constructions of the terms of the Securities Exchange Act are possible, those terms should be given the construction that best serves the Congressional purpose. Champion Home Builders Co. v. Jeffress, 490 F 2d 611, 615 (6th Cir.) Cert. denied, 416 U.S. 986 (1974). Here, plaintiffs argued below that

defendants' omissions to disclose concededly material information during the period while the sales transactions awaited necessary consents, were omissions "in connection with" those sales. Judge Knapp disagreed, pinning his decision on the proposition that the "consents" were no part of the sale transactions. (23a).

The District Court's holding unnecessarily narrows and restricts the Congressional purpose of full disclosure which underlies the Securities Exchange Act of 1934 Section 10(b) and Rule 10b-5 thereunder.

Despite Judge Knapp's ruling, the sale transactions were in no way complete prior to the giving of the consents. At all times from execution of the sales documents by plaintiffs until April 4, 1969 when final consents were given, the selling plaintiffs were still, for many purposes, the owners of the stock, subject to obligations to make loans pursuant to the shareholders agreement, possible legal action, or the like. Indeed, they were entitled to withdraw their consents, certainly after March 1, 1969. Without the information withheld from them by defendants, plaintiffs were deprived of the exercise of knowledgeable consents. Under these circumstances, they were and are plainly entitled to the protection

of the Act. See, Champion Home Builders, supra at p. 616*

Indeed, the duty of disclosure by insiders of material information is so important that the courts have uniformly held this duty to be an absolute one, regardless of any practical effect disclosure might have. Mills v. Electric Auto-Lite Co., 396 U.S. 375, 381 (1970); Sonesta International Hotels Corp. v. Wellington Associates, 483 F.2d 247, 254-5 (2d Cir. 1973); Popkin v. Bishop, 464 F.2d 714, 720 (2d Cir. 1972); Weber v. Bartle, 272 F. Supp. 201, 204 (SDNY 1967) . A fortiori, here the court should hold defendants' fraud actionable where it deprived plaintiffs of the opportunity to exercise informed consents, or to rescind the sales after March 1, 1969.

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* In Champion, the court held the date of a purchase of stock for purposes of Sec. 16(b) of the Securities Exchange Act to have been the date when the directors approved the purchase, rather than the earlier date when the shares were exchanged for value, as the incidents of ownership did not attach until the latter date, and the prophylactic purposes of the act were better served.

POINT III

CONCEALMENT OF THE IDENTITY OF THE PURCHASER OF PLAINTIFF HOLLENDER'S SHARES WAS FRAUDULENT.

Defendant Cohen's dealings with Hollender were deceitful in the extreme. Cohen, a lawyer for KEC, acted in the deal as a secret nominee for one Moskovitz, who was in turn a nominee for Saltzman. Cohen knew that Hollender would not have sold had he known the identity of the purchaser. (Tr. 353-4) This conduct constituted fraudulent overreaching and is actionable.

Failure to disclose the true identity of the purchaser in the sale of shares of a close corporation in itself constitutes omission to disclose a material fact. Strong v. Repide, 213 U.S. 419 (1909); Helms v. Duckworth, 249 F.2d 482, 487 (D.D.C. 1957); Meinhard v. Salmon, 249 N.Y. 485 (1928); In the Matter of Ward La France Truck Corporation, 13 S.E.C. 373, 380-81 (1943).

Here, the undisclosed fact that the ultimate purchaser of Hollender's shares was Harry Saltzman, carefully concealed behind not one but two nominees, was material and operated as a fraud or deceit on Hollender for two reasons.

In the first place, there had been a falling out between Hollender and Saltzman over the firing of a third individual. The defendants conceded that they had used

subterfuge precisely because they knew that Hollender never would have willingly sold his shares to Saltzman. (Tr. 353-4; 21-22).

Second, and more importantly, the very fact that Saltzman was the purchaser would have tipped Hollender off to the fact that circumstances within the corporation had changed -- for Hollender had mentioned KEC to Saltzman in 1968, and Saltzman had replied that he was not interested. (Tr. 117-19).

As far as Hollender was concerned "nothing else had changed in the Kirshner picture that had been in existence at the time Saltzman and [he] talked about the Kirshner thing," and he would have wondered why Saltzman had suddenly reversed himself. (120-21)

In Strong v. Repide, supra, the majority shareholder concealed the fact that he was negotiating to sell the land that the corporation owned, (and which was its only valuable asset) and the fact that it was he who was negotiating through a third party for the purchase of the plaintiff's shares. The court held that Repide had a duty to disclose to Mrs. Strong facts bearing upon or which might affect the value of the stock, 213 U.S. at 430-31.

The court concluded that Repide's concealment of his identity, which he kept up as long as he could, even to the giving the check of a third person for the purchase money, "was a studied and intentional omission, to be charac-

terized as part of the deceitful machinations to obtain the same [shares] at a lower price." (Id. at 433)

Similarly, in Matter of Ward La France, supra, the Securities and Exchange Commission concluded that under the facts of the case the identity of the purchaser was material "as such disclosure might well have led to inquiries or surmises concerning the better condition of the company if not the actual plan afoot." 13 S.E.C. at 380. The opinion continues:

> "Further, those in control not only did not signal any notice of their activities to shareholders; they effectively threw a smoke screen around their activities by dealing with the shareholders anonymously through Heffernan. The last hope shareholders had of learning anything that might have given them a lead as to what was taking place in their corporation was to have learned the true identity of the purchasers of their shares." (Emphasis added.)

Stockholders of a close corporation such as KEC occupy a position similar to that of partners. One court observed that "chartered partnership" or "incorporated partnership" is a more accurate designation of the relationship among the KEC shareholders than "close corporation." Helms v. Duckworth, supra, at 486 n. 6, and held that the shareholders of such a corporation have a fiduciary duty to deal fairly, honestly and openly with their fellow stockholders and to make disclosure of all essential information. Id. at 487.

Not only Hollender, but all three of the plaintiffs were thus put at an unfair disadvantage in dealing with their own corporation by defendants' willful omission to disclose the identity of the ultimate purchaser of Hollender's shares. Defendants sought to hide from plaintiffs the fact that circumstances of the corporation had altered.

CONCLUSION

For the reasons given, the judgment of the District Court should be reversed, and judgment should be entered for the plaintiffs.

Respectfully submitted,

GORDON HURWITZ BUTOWSKY & BAKER
330 Madison Avenue
New York, New York 10017
(212) 661-8330

BERGREEN & BERGREEN
660 Madison Avenue
New York, New York 10022
(212) TE 2-8500

Of Counsel:

Franklin B. Velie
David Brady
Carl Golden
Renee Sacks

7/14

GORDON HURWITZ BUTOWSKY & BAKER
330 MADISON AVENUE
NEW YORK, N. Y. 10017
Telephone – 212–661-8330

for binding copy; all others OK

July 10, 1975

B

Clerk of the Court
United States Court of Appeals
For The Second Circuit
United States Courthouse
Foley Square
New York, New York 10007

75-7284

Re: Barnett et. al. vs. Kirshner, et. al.
Docket No. 75-7284

Dear Sir:

At page 5 of our brief, we state:

> "In early 1968, the defendant Cohen became a shareholder, and also counsel to the corporation."

This is an error. In August, 1968, the defendant Cohen became counsel to KEC. (33a) He did not become a shareholder at that time.

We regret the error.

Very truly yours,

Franklin B. Velie

FRANKLIN B. VELIE

FBV:jc

cc: Harris, Fredericks & Korobkin

Service admitted
July 7, 1975
Harris, Fredericks & Knothen
By Lewis Harris
a member of the firm

Received - 7/7/75 - 2:45 P.M.
Gordon Hurwitz Butowsky & Baker
by
Renée Sailer